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November 8, 1982

Letter Report 260

Honorable Walter M. Ingalls
Chairman, and Members of the
Joint Legislative Audit Committee
925 L Street, Suite 750
Sacramento, California 95814

Dear Mr. Chairman and Members:

In response to a request by the Joint Legislative Audit Committee, we have reviewed the management and administration of the Veterans' Home Post Fund and the appropriateness of the investments of post fund and trust funds monies made by the Veterans' Home of California (home). This review was conducted under the authority vested in the Auditor General by Section 10500 et seq. of the Government Code. We conducted this audit in accordance with generally accepted government auditing standards necessary to accomplish the work requested by the Legislature. However, we did not perform tests necessary for expressing an opinion on the financial condition of the post fund and the trust funds.

We reviewed the home's administrative procedures relating to the management of the post fund and found them to be in conformance with the statutory requirements. We also reviewed the investments of post fund and trust funds monies and found that they were generally placed in certificates of deposit at savings and loan associations; these are acceptable types of investments. Although the home's investments should have been fully secured, as of September 20, 1982, only \$400,000 of the \$3,650,000 total investment was secured. Finally, we discuss the circumstances surrounding the hiring of an ombudsman.

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BACKGROUND

The Veterans' Home of California, located in Yountville, is a home for aged and disabled California veterans. The home provides a community of services for California veterans to improve their overall health, reduce the incidence and severity of their disabilities, and increase their social interaction in an environment that promotes self-reliance and self-worth. The home maintains a medical and nursing facility as well as residential facilities. Approximately 1,400 veterans currently live at the home.

The home is under the control of the Department of Veterans Affairs and subject to the policies of the California Veterans Board. The home's daily operations are managed by the commandant, subject to the direction of the Director of the Department of Veterans Affairs. The Allied Council, an organization of the veterans residing at the home, represents the residents to the home's management. However, the Allied Council does not have any regulatory or management authority that would be binding on the commandant.

The commandant's fiscal responsibilities include managing a post fund and several trust funds subject to the approval of the Director of the Department of Veterans Affairs.* By statute, these funds are excluded from deposit with the State Treasurer. At the close of fiscal year 1981-82, the home's post fund had a cash balance of \$805,552 and the trust funds a balance of \$3,197,802. The home invested \$3,820,000 from these funds in certificates of deposit in savings and loan associations and in two banks.

SCOPE AND METHODOLOGY

To determine the appropriateness of the home's fiscal management practices and the investments made with post and trust funds, we researched pertinent statutes and examined documents and records at the home. At the home and at the

* The term "trust funds" refers to three distinct funds; the trust fund, the welfare fund, and the posthumous fund. The appendix to this report describes these funds as well as the post fund.

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Department of Veterans Affairs, we interviewed staff who are responsible for administering the funds. We also interviewed officials from the State Treasurer's office, the State Controller's office, the Federal Home Loan Bank, the Federal Savings and Loan Insurance Corporation, and the savings and loan institutions in which the monies are currently invested.

We did not conduct a financial audit of the post fund and trust funds accounting records, nor did we review the detailed expenditure records. We provide only a description of the procedures relating to the administration of the post fund; we did not analyze these procedures. Our review of the investment of the post fund and trust funds monies was limited to evaluating whether the types of investments are acceptable and adequately secured. Finally, we reviewed the one specific post fund transaction for which we were asked to provide information relating to the hiring of an ombudsman.

ANALYSIS

We reviewed the home's administration of the post fund to see whether this administration conformed to the Military and Veterans Code. We also examined the appropriateness of the investments made from the post fund and the trust funds held by the home. We found that the home's administrative procedures relating to the management of the post fund were in conformance with the statutory requirements and that post fund and trust funds monies were placed in appropriate types of investments. However, at the time of our review, almost 90 percent of the home's investments were not insured or protected by collateral. The following sections describe the home's administrative procedures and its conformance with statutory requirements, the investments it made with money from the post fund and trust funds, and post fund monies used to hire an ombudsman.

Administrative Procedures Relating to the Post Fund

Sections 1047 through 1049 of the Military and Veterans Code require the commandant to maintain a post fund to be used for the general welfare of the home and its members. The funds are

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to be used at the discretion of the commandant, subject to the approval of the Director of the Department of Veterans Affairs and the California Veterans Board. Further, the Military and Veterans Code allows the post fund to be used to operate the post fund enterprises. These enterprises may be operated at a profit, and any such profit will accrue to the post fund. Additionally, the post fund may be used for a variety of other purposes, such as operating a motion picture theater and a library, and paying for newspapers, chapel expenses, welfare and entertainment expenses, sports activities, and celebrations. The post fund may also pay for insurance to protect the property of the fund and to pay for activities that benefit the home or its members. We found that the home's administrative procedures for managing the post fund were in conformance with these statutory requirements.

The post fund receives revenue from several sources including profits from post fund enterprises, donations, unclaimed trust money of deceased members and discharged members that is on deposit with the home, and proceeds from the sale of unclaimed personal property of deceased and discharged members. The post fund can also receive up to \$100,000 each calendar year from deceased members' estates that are not held in trust by the home. Another major source of revenue is the interest from the veterans' trust fund deposits. The post fund gets all interest in excess of the maximum passbook savings rate that is paid to the veterans.

As we stated previously, the post fund is used to pay for the operating expenses of the post fund enterprises, which presently include a coffee shop, general store, tavern, bus station, and barber shop. The home, in its budget for fiscal year 1982-83, estimates that these operations will generate a profit to the post fund of \$20,000.

The post fund is also used to pay for other services deemed to be for the general welfare of the veterans. For example, the home purchases tickets to sports events and movies, as well as newspapers and arts and crafts supplies. In addition, the post fund is used to employ members of the home to assist in the home's operations. There is the equivalent of 110 full-time positions held by members. These employed members do such things as assist the chaplain, work in the mail room, transport

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ambulatory and wheelchair patients, answer incoming calls, and assist in the recordkeeping in the clinical laboratory. One of the positions paid for by the post fund is the Chairman of the Allied Council, who acts as spokesperson for the members and represents the interests of the members to the home's management in its decision making, including decisions involving post fund expenditures. Finally, the post fund provides \$10 per week in spending money to members who have no income.

A proposed fiscal year budget for the post fund is agreed upon by the management of the home in cooperation with the membership of the home. Every year, the home's Chief of Financial Management Services requires each manager of a post fund activity to submit a formal budget request, including estimates for salaries, operating expenses, and equipment, as well as appropriate information to justify the request. He reviews these requests for reasonableness and consolidates them to develop a requested budget for each activity. Next, a budget is negotiated for each activity. Each manager of a post fund activity meets with the home's assistant administrator, the Chief of Financial Management Services and appropriate staff, the Chairman of the Allied Council, and the Post Fund Advisory Committee of the Allied Council. After all activity budgets have been agreed upon by the appropriate staff of the home and the members, the complete post fund budget must then be approved by the commandant, the Director of the Department of Veterans Affairs, and finally the California Veterans Board. If any changes are made in this final stage, the commandant negotiates the changes with the members of the home.

Investment of Post Fund and Trust Funds Monies

Sections 1035, 1036, and 1039.3 of the Military and Veterans Code require the home to maintain trust funds that include money deposited by the veterans, money and assets of the estates of deceased veterans, and donations to the home. For the period from July 1979 through September 1982, the post fund and the trust funds monies have been invested primarily in certificates of deposit at savings and loan associations. The home has occasionally placed some of the funds in a money market fund that is available on demand. The statutes do not preclude such deposits so long as they are fully insured or otherwise secured. We found that only \$400,000 of the total

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\$3,650,000 invested was secured as of September 20, 1982. We found that the uninvested cash balance was not excessive in relation to the home's periodic cash needs.

The home's process for making investment decisions and investing funds is essentially as follows. When funds become available for investment, the Chief of Financial Management Services and the accounting officer contact several savings and loan associations to ascertain the highest rates currently being offered for certificates of deposit. Occasionally, the Chief of Financial Management Services will contact the Chief of the Investment Division at the State Treasurer's office for advice on whether to invest in short-term or long-term deposits. Upon gathering the information, the Chief of Financial Management Services develops a recommendation stating the institution in which he proposes to invest the funds, the interest rate, and the term of the investment. He schedules a meeting with the home's commandant, assistant administrator, accounting officer, and the Chairman of the Allied Council. The participants discuss investment alternatives and formally agree upon a recommendation. All participants then sign a document indicating their approval of the investment decision. Recently, the Director of the Department of Veterans Affairs, implementing a resolution by the California Veterans Board, revised the process to include the approval of either the Director or the Chief Deputy Director of the Department of Veterans Affairs before the home invests funds.

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The following table summarizes the investments held by the home
 as of September 20, 1982.

TABLE 1

VETERANS' HOME OF CALIFORNIA
 POST FUND AND TRUST FUNDS INVESTMENTS
 IN CERTIFICATES OF DEPOSIT
SEPTEMBER 20, 1982

<u>Institution</u>	<u>Interest Rate</u>	<u>Term</u>	<u>Date of Maturity</u>	<u>Amount</u>	<u>Total by Institution</u>
Fidelity Savings & Loan Association	12.000%	30 months	10/30/82	\$ 250,000	\$ 250,000
Southern California Savings & Loan Association	15.125%	90 days	10/28/82	240,000	
	12.875%	39 days	10/29/82	100,000	
	16.100%	183 days	12/14/82	450,000	
	15.850%	208 days	12/29/82	250,000	1,040,000
State Savings & Loan Association	16.100%	271 days	12/06/82	700,000	
	16.150%	223 days	12/08/82	250,000	
	15.850%	269 days	02/25/83	500,000	
	16.400%	241 days	03/10/83	129,000	
	16.400%	247 days	03/17/83	101,000	1,680,000
Valley Federal Savings & Loan Association	16.125%	179 days	10/15/82	330,000	
	16.250%	178 days	10/22/82	250,000	
	12.750%	39 days	10/29/82	<u>100,000</u>	<u>680,000</u>
Total Investments				<u>\$3,650,000</u>	<u>\$3,650,000</u>

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The investments shown in Table 1 are insured up to \$400,000 by the Federal Savings and Loan Insurance Corporation. We contacted the institutions listed in Table 1 and verified that the home's investments were insured for only \$100,000 at each of the four savings institutions. Thus, as of the date of our review, only \$400,000 (11 percent) of the \$3,650,000 in investments was insured; the remainder was unsecured.

According to the Chief of the State Treasurer's Investment Division, the State Treasurer requires savings and loan associations to provide collateral for the State's deposits by pledging mortgages on real property equal to approximately 150 percent of the value of the investment. The State Treasurer will not invest treasury funds in certificates of deposit of savings and loan associations without such collateral as security.

We asked the Director of the Department of Veterans Affairs why the home had not obtained security agreements in addition to the Federal Savings and Loan Insurance Corporation's \$100,000 insurance for each savings and loan association the home invests in. He stated that he had not been involved in previous investment decisions and that the investment committee must have thought that obtaining security agreements would reduce the rate of return on investments. However, we found that obtaining the security would not significantly reduce the home's rate of return realized on the investments.

Further, if the home is unable to make security agreements for future deposits exceeding \$100,000, the State Treasurer's Trust Services Division can arrange for these agreements. The Chief of the State Treasurer's Trust Services Division has since requested and obtained 150 percent collateral for the \$1,680,000 that the home deposited with State Savings and Loan Association by having the institution deposit mortgages in trust with the Federal Home Loan Bank.

In addition to obtaining collateral as security, the home has other alternatives for reducing the risk to its investments. One alternative that would provide full insurance coverage by the Federal Savings and Loan Insurance Corporation is to diversify the post fund and trust funds investments in different savings and loan institutions with no more than \$100,000 in each. Another alternative that may extend the insurance coverage to the trust funds for members of the home,

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including the funds of deceased members, is to arrange custodial or trust accounts that may provide insurance coverage for all the funds in trust unless any individual member or estate exceeds \$100,000. The Director of the Department of Veterans Affairs should consult with his legal counsel to determine whether this last alternative would best meet the home's needs.

The Hiring of an Ombudsman

We were asked to report the circumstances surrounding the \$3,000 post fund expenditure to hire an ombudsman for the members of the veterans' home. The Director of the Department of Veterans Affairs, acting on his authority to direct the affairs of the home, under Section 1014 of the Military and Veterans Code, hired an ombudsman to facilitate communication between the members of the veterans' home and the Department of Veterans Affairs. This position was initially funded by a \$3,000 salary advance from the post fund.

Before hiring the ombudsman, the Director of the Department of Veterans Affairs asked the Chairman of the Allied Council for his opinion on hiring an ombudsman. The chairman agreed with the concept; however, when the director suggested the name of the person who was eventually hired, the chairman objected. Several days later, on August 23, 1982, the Allied Council met and considered the director's suggestion to hire an ombudsman. The council favored the idea of hiring an ombudsman, but when informed of whom the director had suggested, the Allied Council voted against selecting that person. Subsequently, the director hired the person he had suggested even though the Allied Council did not support the decision.

On September 1, 1982, the Director of the Department of Veterans Affairs (department) requested a revision to the post fund budget to provide a salary advance to the individual he hired to act as the ombudsman. In an interview, the director stated that he felt the ombudsman was necessary to establish better communications between the department and the home's members and to identify the members' concerns. Further, the ombudsman would provide advice on improving the managerial relationship between the department and the home.

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The director also stated that he originally intended to have the position approved by the State Personnel Board as a civil service position. However, he felt that the urgency of the situation precluded him from waiting until the State Personnel Board could approve the position. In addition, he stated that the \$3,000 was an advance that would be repaid to the post fund when the position was approved. The State Personnel Board approved the limited-term appointment as a special consultant to the director, effective September 28, 1982. The position was approved for a maximum of nine months, even though the director had requested the position for a maximum period of three months. The special consultant (i.e., ombudsman) has agreed to reimburse the post fund for the \$3,000 advance by December 1, 1982.

CONCLUSION

We reviewed the administrative procedures of the Veterans' Home of California relating to the management of the post fund and found that they were in conformance with applicable statutory requirements. We also found that monies from the post fund and trust funds were placed in appropriate types of investments; however, the Department of Veterans Affairs should ensure that these investments are fully secured.

Sincerely,



for THOMAS W. HAYES
Auditor General

Staff: Eugene T. Potter, Audit Manager
Karen Nelson
Kathleen L. Crabbe

Attachment

DESCRIPTION OF THE TYPES OF FUNDS
INVESTED BY THE
VETERANS' HOME OF CALIFORNIA

The Veterans' Home of California invests money from several different types of funds. The following describes each fund.

Post Fund - Money in this fund is derived from interest earned on the investment of trust monies. This interest is that which exceeds the maximum passbook rate paid to the veterans on their voluntary deposits. Money in the post fund also comes from donations, profits from the operation of the post fund enterprises, and unclaimed money and the proceeds from the sale of unclaimed property from the estates of deceased veterans and discharged veterans. The cash balance in the post fund as of June 30, 1982, was \$805,552.

Trust Fund - These are monies voluntarily deposited with the home by the veterans. Any deposits of a veteran who leaves the home but who does not claim his funds within two years for amounts of \$3,000 or less or within five years for amounts over \$3,000 are deposited in the Veterans' Home Post Fund. As of June 30, 1982, the balance in the trust fund was \$1,635,501.

Welfare Fund - This fund includes cash donations and other gifts that are held in trust by the commandant. These funds are used for the general welfare of the veterans and for the specific purpose designated by the donor. The balance in the welfare fund at June 30, 1982, was \$79,522.

Posthumous Fund - This fund contains unclaimed money of deceased veterans. The home holds these funds in trust for between two and five years. If the amount of the veteran's estate is \$3,000 or less, the funds are held for two years; if over \$3,000, they are held for five years. After the appropriate holding period elapses, the unclaimed funds are deposited in the Veterans' Home Post Fund. As of June 30, 1982, the home held \$1,482,778 in the posthumous fund.

MEMORANDUM

To : Thomas W. Hayes
Auditor General
660 J Street, Suite 300
Sacramento, CA 95814


Date: October 20, 1982

From : Department of Veterans Affairs

Subject: POST FUND AUDIT RESPONSE

The Department of Veterans Affairs has reviewed the draft report issued on October 15, 1982. This report prepared by the Office of the Auditor General concerned the California Veterans Home's management of its Post Fund. Our review determined that the contents of the report are essentially accurate.

The report's conclusions specify that the Department should ensure that Post Fund investments are fully secured. An effort to achieve this goal has already been initiated, and it is the Department's intent to assure that all subsequent investments are secured.



MANUEL VAL
Director